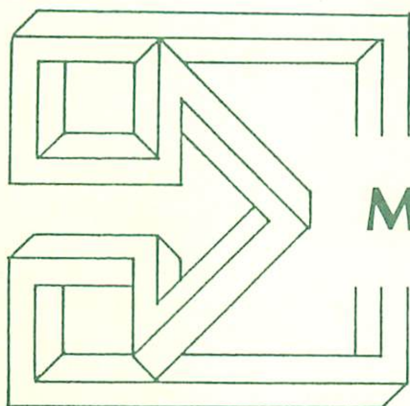

Marine Partnerships

Their various forms and legal ramifications

by L. B. "Jake" Jacobson

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INTRODUCTION

The following information deals specifically with fisheries partnerships. Basically, a partnership is a venture including two or more persons in the operation of a business for profit. In the Alaska Partnership Act, the Legislature has adopted the provisions of the Uniform Partnership Act. The terms of the Uniform Partnership Act in Alaska are basically the same as those found in Washington, California, and elsewhere. Most of the states have adopted it without modification. To be a partnership or to form a partnership it is <u>not</u> necessary to have a formal, written instrument saying, "we have hereby formed a partnership doing business under the name of XYZ."

A typical case of this sort would involve two or three people who cooperate on a venture that is successful and is perpetuated. The partners share in the endeavors, the contributions, and the profits. Everything is just fine until one of them dies or they have a disagreement. Suddenly the unsuspecting partners examine their business status and find that they have been in a partnership. Frequently legal decisions, sometimes to the surprise of the partners, have determined that partnerships can <u>exist</u> by reason of their historic method of doing business. The surviving partners will find the terms of partnership operation in law are not different from the methods by which they operated.

You have heard it said that "the law is unintelligible." In many areas of law this may possibly be so, but partnership law is a pleasant exception. If the layman were to draft his own partnership law and prescribe the terms by which a partnership would be formed, operated, dissolved, and terminated, this draft would compare substantially with the common sense approach

of the Partnership Act. You may safely assume that a partner who conducts his affairs on behalf of the partnership in a reasonable manner will be completely within the scope of the operations. He will have to reimburse his partners when he transcends those reasonable bounds.

WHO'S RESPONSIBLE?

In a partnership, all partners are liable for the obligations of the partnership. This means that your partner or partners can involve you in substantial financial obligations on behalf of the partnership, whether or not those transactions were undertaken in good faith. A written agreement must define the "scope" of the partnership business. That is, it must define the liability of the partners to third parties, specifically, to creditors.

A written agreement can define the extent to which a partner, or an agent on behalf of the partnership, acts within the agreement, with the understanding that the partnership is liable for the resulting obligations. For example: you and two or three people go into a fishing venture. One of your partners drives your car to get a net or some gear, has an accident and injures another party. That party will sue the driver of the car, your partner. The partner then will sue the partnership. If you are a member of the partnership, you are accountable to that person and you will have to respond to the damages. This really raises an important question: what is the extent of your liability exposure? The answer is: your neck is extremely exposed.

In a typical partnership, your liability is not limited to the amount of your financial contribution in the partnership. Let us assume that four of you each put in $20,000. A person is injured by a member of the partnership, and is awarded a $300,000 judgment against the partnership. Is he limited to recovering $80,000? No! The injured person will get the full judgment against that driver and, in turn, a judgment against the partnership, including the partners jointly and separately in order to get the full settlement. The injured person will get all of the partnership's profits, income, and assets. If more money is needed to satisfy

the judgment, a deficiency judgment will get it from your personal property and your real property at home. If you have any houses, cars, or anything else, you can bet that execution orders will be issued from the court to satisfy the full judgment.

Now let's take a different situation involving a partnership. You return to port, the boat is tied up, business is done, and you go home. One of the partners, partner A, goes out Saturday night and has an accident on the way to one of the local taverns. This is clearly outside of the scope of the partnership business. The mere fact that he ran over and killed somebody resulting in a $300,000 judgment against A, does not mean that the representative of the dead person's estate will make you respond, even though you are members of the same partnership as A.

WHAT DOES A PARTNER OWN?

When you are a partner, you basically have three things: your capital contribution, which you own; your partnership interest, which is your right to receive the profits and the surplus; and your right to manage. In a general partnership, each of the partners is an "equal manager." If there are two partners, then you simply have to work out conflicts by diplomacy because, in the event of a disagreement you can't vote to make a decision. Assuming you have an odd number of equal partners, a majority will control the ultimate resolution.

A WRITTEN AGREEMENT

The resolution of business conflicts within a partnership can be modified by written agreement. Under no circumstances should people be partners without written agreement. Provisions should be clearly stated in the agreement to be sure all partners understand what will happen when one enters or leaves the partnership.

Without a written agreement, the partnership can be terminated at any time, often without warning. It will dissolve when a partner dies, is bankrupt, or quits. You can write a provision into your agreement for the

continuity of the partnership. It may continue to do business under certain stated terms, and continue to use the partnership name, despite removal of a partner.

BUYING OUT

A "buy-out" provision should be in your partnership agreement. Let us assume that one of the partners decides not to continue in the venture and wants out. These situations can be regulated by a "buy-out provision" in the written agreement. This provision contains a method for evaluating the departing partner's interest. An appraiser or an assessor may be hired to figure out the value of all of the properties in the partnership and to divide it into equal shares, thereby deducing the value of one share. The departing partner would then be paid off.

Another common provision in a partnership agreement deals with the situation in which the partners can't resolve differences and one of them decides to leave. Under this provision, each partner will write down his best cash offer to the other partner or partners for the departing partner's interest. The remaining partners can then buy out the other and become the exclusive owners. The highest price or offer is the one that governs.

Since the buy-out provision can be handled in many ways, one of the critical provisions in the written agreement is the <u>method</u> of payment or buy-out. Often the remaining partners do not have the necessary cash at that particular time. Frequently, the provision calls for an appraisal of the departing partner's interest. Coupled with this is a buy-out plan that might, for example, include a cash payment of $10,000 at the time of the dissolution, another payment 12 months later, and annual payments afterward until the total is paid.

DEALING WITH YOUR PARTNERS

Flexibility is the important thing in your partnership agreement. It should be clearly mentioned that a partnership agreement does not have to strictly adhere to all of the rules in the Uniform Partnership Act. As far as the relationships between partners are con-

cerned, you are at liberty in your agreement to state whatever rules on which all partners are agreed. One partner, for example, may not have voting control. In the absence of a written agreement, however, all partners are presumed to have made equal contributions and shall receive equal distributions. This rule can be modified in a written partnership agreement.

MANAGEMENT CLAUSE

You may want a management clause in your partnership agreement. What do you do when two partners disagree on a substantial issue? This type of situation can be addressed in the management agreement. One of the partners, for example, can be appointed as general manager. Disagreements on major issues can also be resolved by arbitration, or referred to another group that resolves the issue for the partnership.

AUTHORITY CLAUSE

The most important clause in the partnership agreement is probably what I call the "authority clause." It limits authority. In the absence of such a provision, each of the partners is a general agent for the partnership. Each member of the partnership will be responsible for all of the financial and operational obligations any partner may incur. Any person dealing with a partner who believes the partner is acting within the proper limits of authority, can extend credit and is entitled to hold the partnership, and all of its partners, responsible for payment of that obligation. One of the best ways around this problem is with a clause in your partnership agreement which limits the partner's purchasing authority. Agreements often say that one partner cannot make a purchase in excess of, say, $1,000 without a partnership meeting and the written consent of the partners.

The same principle would operate with respect to making loans and taking out loans on behalf of the partnership. Any one of the partners has apparent and inherent authority to go to the bank and take out a loan. The banker, if prudent, would presumably require more than one signature.

One partner could bind the others for a partnership loan which was taken out within the scope of the partnership business. The way to limit this potentially hazardous situation is to prohibit loans by one partner in the absence of a written agreement from the other partners. If you then found that partner A has signed a loan on behalf of the partnership that you never knew about, you have recourse against partner A, who was something less than candid with you and clearly exceeded the scope of his authority. The bank will still hold you responsible for the loan but the authority clause provision in the agreement gives you recourse for indemnification against that partner.

Another aspect of the authority clause addresses the situation where your partners are absent, and certain things need to be done on behalf of the partnership. A partnership agreement can give power of attorney to a specific partner to perform certain acts, such as selling real estate, making big loans, and such other major transactions as may be contemplated in advance by the partners.

The last aspect of the authority clause is a possible provision precluding any partner from hiring employees on his own. The justification being that each partner is a potential employer. You have a very simple, understandable working relationship. You are all bosses. But if you deviate from this form of business and the partnership hires employees, you add an employer/employee relationship, and it's a whole new ball game.

All of the partners, in my opinion, should be consulted before employees are hired. I don't know what kind of business you are contemplating. However, in a small fishing enterprise, if you are talking about a crew for a boat, you would want to have an employee relationship provision in your partnership agreement.

WHO'S LIABLE?

Another essential clause in your written partnership agreement would address the issue of partnership liabilities. The easiest way to cover liabilities is to purchase insurance. The partnership has an exposed

throat just as you do. As a matter of fact, there is very little difference between you as an individual and you as a partner. The personal aspects of financial exposure can take money out of your wallet quite easily. A partnership is not like a corporation, where the amount of your liability is limited to the amount of your contribution to that particular corporation. In a partnership, your house, your car, and everything you own may be taken away if the partnership performs badly or encounters a risk and suffers a uninsured loss.

I don't want to dwell on liability, but I do want to emphasize four areas where there is a significant risk and where insurance is appropriate. First, the partnership ought to obtain general liability coverage. This covers such things as the previous accident example where one partner driving to get the nets runs over a person. Second, obtain additional insurance to cover the "care and maintenance" responsibilities that go with the operation of your vessel. Third, you will want something in lieu of your workman's compensation insurance that will take care of you, all of your crew members, and all of your employees. You can purchase the insurance to cover all of the people who will be on the boat. Fourth, you should purchase property insurance to cover the loss of your property. Your boat hits a reef and sinks. Unless you are independently wealthy and, can afford that kind of a loss by writing off the boat and obtaining favorable income averaging, you had better buy insurance.

You may also wish to protect your business in the event of a partner's death. Written agreements or life insurance can cover this problem. Assume a three-person partnership with assets of about $150,000. Partner A dies. Without written or other provisions, the business is dissolved and the assets split equally among the partners and the deceased's estate. A written agreement may specify however, that A's estate is immediately paid some portion of his interest in the venture. The rest stays in the business for a period, and the estate is paid off gradually.

Another possible solution is to take out individual life insurance policies on each partner in the name of the

business. When one of them dies, the policy settlement is immediately used to pay off the estate, and the business continues to operate. This is a clever mechanism and some form of it is absolutely necessary to preserve the financial viability and continuity of the partnership. The premiums are also tax deductible.

DIVIDING THE SPOILS

The Uniform Partnership Act assumes that each partner's capital contribution to the partnership is equal. This is not necessarily the case. A partnership agreement should reflect exactly what contributions have been made. For example, three men band together to form a viable fishing operation. Partner A has a bare boat, partner B has a permit, and partner C has contributed $50,000 cash, which is the operating capital for that year. All the partners have made contributions necessary for the business, but the value of those contributions is unequal. A's boat may be worth $80,000 or more. B's permit may be worth about $30,000. C's $50,000 cash is easy to evaluate. You want to have a provision in your written agreement that identifies or assigns a value to each of the capital contributions at that particular time.

Without a written agreement, the partners will divide the net profit from the partnership operations equally. With a written agreement, the profits can be proportionately divided according to the stated value of capital contributions. This way the boat is worth $80,000, the permit is worth $30,000, and the cash is worth $50,000, the distribution of profit does not have to come out equal or identical. Profit payments can be whatever you specify them to be in your partnership agreement. On the other hand, you can agree to put in unequal amounts of capital contributions and still divide profit equally. Obviously, I don't believe that this will happen very often, but it should be mentioned for the simple reason that you are at liberty to bargain and receive the terms which you think are advisable and agreeable to you.

GETTING OUT

The last thing you should have in your partnership agreement is a provision describing what happens upon the termination of the venture. Your partnership operates for a while and then it dissolves, or something might happen to cause an automatic dissolution. After the dissolution the partnership will continue for a period while it finishes its operations and makes the transition to termination, or reformation of the partnership with different partners. Basically, the process proceeds in the following manner: you start a partnership, it operates, you have a dissolution, a wind-up period, and finally you have termination.

Your partnership agreement should specify the events which cause dissolution. One of the things you will probably want to stipulate in your partnership agreement is that the death of a partner will not cause dissolution. The justification for this is rather obvious. For example, if a partner dies right in the middle of the fishing season, you don't start arguing about how to split up the partnership assets, because the boat, the gear, and all of the partnership assets will be taken out of production to settle the estate.

While winding up a partnership, the partners can contract debts on behalf of the partnership even though there has been a dissolution. Let us say that one of the partners wants out. The partnership has entered dissolution. If the partnership still has business to do, unpaid bills for example, a few things may be left in progress. The rule is that a partner may incur debts on behalf of a partnership in dissolution as long as they are undertaken in order to wind up the partnership.

A partnership interest is not freely transferrable. If A, B, and C have a partnership, C cannot decide he wants out and plug in his brother-in-law, D. If so, A and B might suddenly find themselves partners with somebody they don't know and don't trust.

WHY HAVE PARTNERS?

Now I will mention advantages of a partnership as I understand them. First, a partnership is easily understood. Most people understand what a partnership is. You have probably already been in one, formally or informally. Also, the people with whom the partnership deals would similarly understand it. A second advantage of a partnership is that all partners are essentially employers; they are equals. Also, a partnership avoids the workman's compensation insurance requirement. Unless employees are hired, workman's compensation is not required.

Another advantage of the partnership is fewer reporting requirements than for a corporation. A fourth feature of the partnership is cleaner tax reporting. A partnership does not pay any income tax. Also, it is not as expensive to take money out of a partnership as it is with a corporation. The corporation's money is taxed twice, because the corporation has to pay income tax and you will have to pay income tax on the dividends which you receive.

Partnership dissolution is "painless" in terms of tax losses. Upon dissolution the partner will receive his capital contribution from the partnership tax-free. In contrast, books have been written about what happens to the assets and shareholders of a corporation when the corporation dissolves. The tax consequences of a corporate dissolution can be awesome. It is not at all like the dissolution of a partnership, I can assure you. Also, with the consent of partners you may substitute partners instead of having to dissolve. The new partner assumes the retiring partner's obligation and a creditor may look to a new partner to assume the former partner's obligations.

Because fishing is a seasonal business there is reason to reform your partnership organization from one year to the next. The partnership, from this specific perspective, enjoys a distinct advantage over the corporate form of business. A partnership can be dissolved on an annual basis without any dire consequences and without a great deal of paperwork. This is not true in all respects to a corporation. A corporation must pay

substantially greater attention to its paperwork. The dissolution of a corporation is a technical procedure which needs to be followed carefully.

Why would you want to dissolve a partnership annually?

You may not want to, but suppose you have four partners one year and one of them had marital problems and will be leaving for California the next year. You are going to have only three partners in 1980. This can be easily accommodated in a partnership. I do not mean to imply that you should dissolve annually. There is no reason to dissolve a partnership and cause it to terminate on an annual basis if it is operating well. Many partnerships will operate for a great number of years and make necessary adjustments by bringing in new partners with amendment to the partnership articles. An amendment is as simple as the partnership agreement.

On the other hand you can add new people to a corporation by issuing more stock. This procedure does not require a great deal of effort, and little technical expertise or reporting. But in terms of dissolving the business, the partnership is far simpler compared with the procedure required for the dissolution of a corporation.

Another advantage is that partnership law is very simple, contained in Title 32 of the Alaska Statutes. The Uniform Partnership Act and Uniform Limited Partnership Act totals about 30 pages. Corporate law is quite sophisticated and is much more detailed. The last advantage is that partnership law does not change very much; there are very few amendments. If you look at the supplements of the statutes you will notice that there have been no amendments in recent years.

DISADVANTAGES OF PARTNERSHIPS

A partnership can also have disadvantages. The most obvious is that a partnership may be of limited duration. It may have to dissolve when a partner dies, becomes bankrupt, or quits. There are several other provisions in the statutes that will cause the partnership to dissolve. One of them is insolvency. The

assets of a partnership are not as capable of valuation as the assets of a corporation, and are not freely transferrable. With a corporation it is possible to sell shares of stock unless there is a transfer restriction clause. Your partnership interest is not something that can be freely assigned. It must have the consent of the remaining partners.

In a partnership each general partner has a financial obligation to all of the other partners, and this requires exercise of good judgment. Other obligations include furnishing the other partners with an accounting and communicating with them on the financial condition of the partnership. I would consider that to be a disadvantage. It is a lot easier to be a sole employer and hire some employees, for example, to run your boat. You know how the boat works, and how the books work, and you are in charge of the accounts. You do not have an obligation to relay detailed financial information to your employees. You may, however, be required to do so under terms of the crewshare agreement if you choose to pay your crew that way.

The biggest disadvantage in my opinion, is that partnership liabilities are personal. If the partnership is unsuccessful, it is going to hurt you in the wallet. You will not lose just your capital contribution. It can easily exceed this amount. This is in contrast to a corporation where all you lose is the amount you paid for your stock.

One of the aspects of a "limited partnership" that I find undesirable is the certificate you must file in a recording office containing a disclosure of the financial interests of all the people involved. If you are a person who likes to keep your business and your finances private, then you must necessarily regard this as being unfavorable.

A partnership operation may also be interrupted and its assets seized if one of your partners turns out to be a financial deadbeat. Remember, each partner's interest consists of his capital contribution, his interest in the partnership, and his management rights. If you have a partner who has a judgment against him by his former spouse for delinquent child support payments for

example, you, as a partner, may be served with a writ by the Alaska State Troopers directing that certain wages be seized. Now these wages of fishermen on a registered vessel would be exempt from attachment, I understand, under the Jones Act. But in a nonmaritime partnership, a partner's income may be seized. If you decide, for example, to make income distributions on a bimonthly basis, you can find those interests are subject to garnishment. The delinquent partner's capital contributions may be seized and sold, extending to the general partnership assets, too.

Let me give you a specific example. Assume the partnership owns a major piece of equipment and it belongs to the partnership as a whole. It is a general partnership asset. That piece of equipment may be sold to satisfy a personal judgment against a partner for his debt incurred outside the scope of business. The judgment creditor can retain sale proceeds equal to that partner's contribution and interest. In the context of fisheries, alimony and child support are the only exceptions to the general rule that a seaman's wages cannot be garnished or attached.

A major disadvantage to partnership is that it cannot have a profit-sharing plan and trust agreement. You can only have a profit-sharing plan with a corporation. I have been a member of both a partnership and a corporation in the practice of law. (Speaking from my own professional experience, I would advise against a partnership and in favor of the corporate form for the two basic reasons: being able to have a profit-sharing plan and the limited liability extended to the corporation.)

In the context of fishing, a partnership is advisable if it is convenient, if you can find a trustworthy partner, and if you need additional capital. It is bad if you don't like paperwork. It is bad if you don't have partners who will pull their load. And it is bad if you have children who can do the work instead.

LIMITED PARTNERSHIPS: A BRIEF DESCRIPTION

A brief amount of attention must be given to the limited partnership and how to set one up. The limited partner is similar to the corporate investor who has the preferred stock in a corporation. These people who get paid first. There is a basic distinction between a partnership and a limited partnership. The limited partners are not liable for the general obligations of the partnership and do not have any management authority. This is in contrast to the general partnership where all of the partners are liable for partnership obligations. Unlike a general partnership, a limited partnership cannot be established by a mistake or historic method of operating.

To form a limited partnership, you must file a limited partnership certificate in a recording office. Its specific requirements are set out by statutes. This certificate identifies who the general partners are, who the limited partners are, the amounts of their contributions, and what profits the various partners are to receive. If you comply with the statutes or if there is a good faith attempt to comply, the limited partners will be entitled to the benefits and the protections that go along with the Uniform Limited Partnership Act.

A CONCLUDING ENTREATY: CAPITAL CONSERVATION

This next comment may be a little bit beyond the scope of partnerships, but is necessary. I would like to talk about money. What should you do with the money that you have made? I see a lot of fishermen in business. I know what many of their problems are. Most fishermen are hard-working, industrious, and quite independent. But on the other side of the ledger, most fisherman I see are not very careful about paperwork and not thinking in terms of where the business is going this year and where it should be next year. My advice about keeping the money that you've made, is to break it into two simple categories. The first deals with making money during your life and the second is preserving it upon your death.

During your life, the "conservation of capital" is relatively simple. I would break it down into three parts. Continuous business planning is the most important feature. A fisherman who fishes without consulting his accountant and his lawyer periodically is making a big mistake. The tax laws look simple. There is a tax schedule in your tax code. It says that you will have to pay a tax and provides a schedule for the necessary calculations. You can put that on one or two pages of a tax form.

But you know the codes are much more complicated than that. The rest of those forms and the volumes of tax regulations that go along with them, are nothing more than restrictions, loopholes, and exceptions to the general law. If you want to fish and pay taxes the easy way by the general schedule without taking advantage of exceptions and loopholes, then you deserve everything bad that happens to you. Quite simply, you will not be able to improve your status in life. The tax laws and the necessary accounting procedures are sufficiently sophisticated that the fisherman who attempts to get by without using a lawyer and accountant on a regular basis is going to let money slip right through his net.

The second thing I think any fisherman can do during his life to keep some of that hard-earned money is to enter into either a Keough plan or a profit-sharing plan. If you are an individual working for yourself, you are entitled to have your own Keough plan. You can go down to any bank in your town. They will have a plan which is very simple and serves as a type of a tax shelter. You should take advantage of it. If you are an employee of a corporation which has a pension plan or a profit-sharing plan, you will find you are <u>not</u> entitled to have a Keough plan on top of profit sharing. If you are a member of a partnership, you may have your own Keough plan.

A partnership <u>cannot</u> have a profit-sharing plan. The profit-sharing plan and the pension plan are reserved for corporations. If you form a corporation, you will probably not want to have a pension plan because it involves a lack of flexibility. Even in a bad year or an off year, the corporation must fund the pension plan

whether or not there are any profits. This might entail going to the bank to borrow money to pay the pension plan. By contrast, the profit-sharing concept offers a great deal of flexibility. The corporation is not obligated to make an annual payment to the profit-sharing plan unless there is a profit, and the amount of that funding is established by the board of directors.

The third thing I would urge with respect to saving money is the simple idea of income splitting. If you can break or divide a large income down into two or more categories, then you are subject to smaller percentages in terms of your tax liability. A good example of this is the starting fisherman who wants to work his way into a business. He has been a crewman and now he wants to do it for himself. The first thing he does is buy a boat. That might be a strategic error. This is an oversimplification in terms of available cash and loans, I realize. But the individual who rushes into a business situation involving an initial cash outlay of $25,000 to $50,000 is making a mistake.

If you took that money and gave it to immediate relatives instead, you could deduct virtually the whole amount from your taxes. New gift tax laws allow you to deduct up to $3,000 per person per year. These relatives, your children for example, then take the money and form a trust. The trust is a separate taxable entity with its own tax responsibilities, including income tax. The trust takes out a loan and purchases the boat. You lease the boat from the trust with rental payments designed to cover the loan payment. Those rental fees are business expenses to you, and are also tax deductible.

There are many forms of this arrangement which allow the fisherman to buy a boat, take various tax deductions on the capital, and will part of his estate to his family in his lifetime, allowing that capital to work for all of them.

The best way to preserve the money in your estate in the event of your death is to make sure that you have a good will. If you have careful estate planning during the course of your life involving gifts, trusts, and

appropriate revisions of your will, your estate tax should be minimized and in many cases liability can be avoided altogether.

QUESTIONS AND ANSWERS

QUESTION: We were talking about the ease of adding and subtracting partners in a partnership. It seems that the additional paperwork, licenses, insurance and so forth would make it more and more difficult to add and subtract partners.

ANSWER: Well, the paperwork is necessary. The most difficult part about adding a partner is agreeing on the value of what he contributes. In a general partnership, the contribution may be services rather than an asset or a certain amount of cash. But, if you can agree on what he puts in and what he gets out, then all you have to do is take care of the paperwork. You can modify your partnership agreement and it is not very difficult.

QUESTION: Say three partners buy a boat together and they have a $100,000 note with some lending agency on that boat. The one partner wants out, but he still has his name on the mortgage. How does he get out? Must they first satisfy the bank?

ANSWER: Absolutely.

QUESTION: With reference to the previous question, how is a signature removed from the mortgage?

ANSWER: You may find that in most cases the bank will not allow it. I would advise the bank not to. It is like marriage. A marriage is a highbred form of partnership. If the husband and wife are divorced, the bank will not necessarily abide the court's order that the wife,

for example, gets the house. If you miss a payment on the mortgage, the bank will go after whoever they can, usually, the person who has a "deep pocket." The partners in your case are jointly and severally liable, which means that the creditor is entitled to satisfaction through any partner who might be available and who has the money. The creditor can get the money in uneven amounts. He does not have to get one-third of the note payment from partner A, another third from B, and the final third from C. The creditor can get the whole thing from A, or he can get half each from A and B and not touch C who has gone to Mexico.

QUESTION: Again referring to the first question, would you say that before permanent partnership changes could be made the mortgage would need to be satisfied?

ANSWER: Yes. If partner C wants out, C still has a problem at the bank because he signed the mortgage note. You can have a substitute partner brought in to assume all of C's obligations. This would not compel the bank, however, to let C off the hook. The bank might allow this if C is financially responsible and has a good financial statement. In this case the bank may release C and substitute D.

QUESTION: What type of financial trust were you talking about a minute ago? Is that trust similar to the corporation?

ANSWER: Let's look at a "inter vivos trust", which means it is a living trust. This is a trust that is set up during your lifetime, rather than a trust that is established upon your death. You will commonly find in a will one or more trusts that can be established upon your death.

You will probably have two of them if you make a lot of money and if you anticipate leaving a substantial amount of money in your estate. One trust would probably go to your wife and the other to your children.

There's not too much magic in setting up a living trust for your children. It is just a piece of paper. If established carefully and correctly, it is a separate taxable entity. It bears a duty to report and pay taxes on ordinary income just like another taxable entity. The advantage is, as you can see, that the amount of your taxable income is decreased by the trust. You have two lesser amounts instead of one large one. Your income is subject to lower tax rates because of your contribution to the trust. The progressive income tax scale does not have quite the impact on the trust or you that it might have on you alone if you didn't contribute to the trust. You simply designate the children as beneficiaries of the trust. They could be the people that put the money in the trust. You can do it any way you want.

QUESTION: Is the information of a trust done through a regular certified public accountant?

ANSWER: No. It is usually done through an attorney. The CPAs usually do all the accounting work on the trusts. You will probably find that the attorney will set it up and that the CPA has the greatest involvement in two other areas: tax reporting and investment decisions. You can annually give money to your children. Assume that you have three children, and you can give $3,000 to each of your three children, then that's $9,000 of your income, normally taxed,

that is invested without <u>any</u> gift or estate tax consequences. The trust can be making money for them.

The trust is going to have more and more money to reinvest. Your CPA becomes involved because his advice, compared with that of others, is often superior. He manages your books and knows what the good investments would be. You, of course, want to divert these trust investments back into the kinds of resources and capital equipment you need for your fishing business. Have the trust purchase this type of equipment. The trust will have an equity in the equipment and be able to go to a bank and borrow money to purchase the remaining needed equipment.